

## TRANSFER PRICING AND THIN CAPITALIZATION'S IMPACTS TOWARDS TAX AVOIDANCE: CORPORATE GOVERNANCE MODERATION

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### Abstract

The sort of manufacturing company that contributes the most to taxes could continue to be involved in tax avoidance. The issue of tax avoidance is still being hotly debated, even in the G20 Movement, which was recently implemented in Indonesia. This study uses quantitative research and secondary data analysis. There are four variables used in this research. Transfer pricing and thin capitalization are used as two independent variables because they are critical elements that are frequently used in tax avoidance strategies. Tax avoidance is the dependent variable, and corporate governance is the moderating variable. Corporate governance is a component that can reduce the impact of tax avoidance through internal business rules. In this research, the hypotheses are analyzed using a multiple linear regression model, and the classic assumption test is used to determine whether the data received is normal and suitable for testing. In this research, manufacturing firms that were listed on the Indonesia Stock Exchange (IDX) between 2019 and 2021 are used as a sample. The findings of this research showed that transfer pricing and thin capitalization have no impact on tax avoidance and corporate governance as a moderating variable cannot reduce the influence of tax avoidance.

Keywords: transfer pricing, thin capitalization, corporate governance, tax avoidance

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### INTRODUCTION

The purpose of this research is to evaluate whether transfer pricing and thin capitalization influence tax avoidance and whether corporate governance perceptions might moderate the relation between transfer pricing and thin capitalization as well as tax avoidance. In 2021, there is a significant rise of around 20.4% from tax income in 2020, Indonesia reported tax revenue of Rp 1,547 trillion (Statistik, n.d.). While the amount of Indonesia's tax income in 2022 would be Rp 1,924 trillion, up almost 24.4% from tax income in 2021. It shows that one of the sources of financing for state needs comes from tax income. State budget receives 80% of its revenue from tax receipts. All of the amounts of tax are used for developing the infrastructure of a country. Indonesia's tax revenue at the end of the June 2022 period was IDR 868.3 trillion (Birokrasi, 2022). This tax revenue growth is 55.7% from 58.5% of the target set forth in Presidential Regulation Number 98 of 2022. Unrealized taxes have indications of tax avoidance practices. Therefore, the tax avoidance field is still interesting to be further examined.

A claim made in a report known as Corporate Tax Statistics that was published by the Organization for Economic Cooperation and Development (OECD) supports the presence of ongoing tax avoidance. Information on international taxation is included in Corporate Tax Statistics. The report demonstrates that Multinational Companies (MNC), manufacturing businesses and distributors dominate the commercial operations in tax haven countries. The strategy of shifting profits to jurisdictions with more favorable tax rates or lower tax rates is known as transfer pricing.

According to past studies on similar techniques, MNCs attempt to avoid tax liabilities by influencing transfer prices ([Amidu et al., 2019](#); [Pratama, 2020](#); [Ramdhani et al., 2021](#); [Tambunan et al., 2019](#)). Transfer pricing manipulation offers multinational companies the chance to transfer earnings from their source countries to countries with lower tax rates (tax haven country). Due to a lack of human resources to manage the complex nature of transactions conducted within linked businesses and insufficient legislation to end the practice, this impact is frequently seen in poor countries ([Amidu et al., 2019](#)). Companies may modify the pricing charged for goods or services supplied from one firm to another in an effort to lower their tax liability. Utilizing related parties' affiliation, transfer pricing is done. Most countries have a significant tax issue including transfer pricing cases ([Pratama, 2020](#)). Transfer pricing is the practice of multinational companies moving their tax obligations from countries with huge taxes to countries with minimal taxes, which is considered to reduce or eliminate a nation's potential tax revenue ([Ramdhani et al., 2021](#)). Transfer pricing, a method of tax avoidance, is believed to have a positive influence on this study.

Another factor that could be the reason for tax avoidance activity is thin capitalization. Thin capitalization, another method of tax avoidance, is considered to have a positive influence on this study. Thin capitalization is another popular strategy employed by Multinational Companies to avoid taxation in addition to transfer pricing. By raising borrowing, adding interest, and cutting profits, which is frequently done by corporations, taxpayers attempt to decrease the tax burden. When a company's debt exceeds its available capital, it is said to have thin capitalization. According to [Prastiwi & Ratnasari \(2019\)](#), thin capitalization is advantageous for minimizing tax where debt financing is increased with high tax rates until it exceeds capital in order to take advantage of lower interest rates on the corporate tax base. Since there are restrictions on the capital structure in some countries that prohibit interest-bearing debt, firms frequently grow interest-bearing debt, making the capital extremely small. This is how thin capitalization works ([Aprilina, 2021](#)).

There are various methods for businesses to avoid paying taxes, but the corporate governance is working to make it more difficult for them to do so. One such effort is the development of corporate governance regulations. According to [Dianawati & Agustina \(2020\)](#), effective corporate governance can lower managers' tax avoidance. Corporate governance is a framework for business management that aims to ensure that the organization operates ethically, responsibly, effectively, and fairly. Reduced danger of tax avoidance by businesses is going to be made possible by effective corporate governance. This theory is also consistent with findings from [Wahyudi et al. \(2021\)](#), which show that corporate governance at the business level might minimize tax avoidance practices. In order to prevent or reduce tax avoidance in this study, the moderating variable, corporate governance, is anticipated to have a negative influence.

In the modern world, tax avoidance is still widespread, and Indonesia is not an

exception. As evidenced by the fact that one of the discussion points of the Bali Declaration, which 11 nations, including Indonesia, signed, exists. Some countries in the globe actively avoid paying taxes, which is a significant cost on the country. Researchers have access to resources and opportunities to conduct study because of the occurrence of tax avoidance and its contributing causes. The way the corporation now manages its taxes and how its operating system functions both point to possible tax avoidance by the company.

The fact that there are gaps in previous research strengthens the case for conducting further. [Ramdhani et al. \(2021\)](#) stated that transfer pricing holds a positive impact on tax avoidance; the effect of transfer pricing is represented by the big and small tax burden that is defined on the profit. In other words, businesses continue to believe that transfer pricing is a method of minimizing taxes in order to increase profits. [Ramdhani et al. \(2021\)](#) said that thin capitalization could help a corporation avoid taxes; the more debt a company has, the more likely it is that it is using tax avoidance strategies. However, to limit the interests of shareholders and management, a company's corporate governance framework must have proper rules and mechanisms. The moderation of corporate governance is anticipated to hold a negative impact on tax avoidance treatment since it has been shown to be capable of preventing tax avoidance by corporations.

## LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

### ***Transfer pricing on tax avoidance***

Transfer pricing is the process of determining whether prices that have been agreed upon by the linked parties to be significant or insignificant are large or little depending on related business rules. Significant pricing fluctuations established by associated parties may have underhanded motives to avoid taxation.

Research by [Sebele-Mpofu et al. \(2021\)](#), which looked at the transfer price manipulation approach held by multinational enterprises to reduce their tax burden in developing countries, lends support to this. According to an additional study by [Bartelsman & Beetsma \(2003\)](#), variances in revenue in some nations with high tax rates cause the majority of the company's income to be lowered when reported on the income statement. For the goal of transferring earnings to nations with lower tax rates, transfer pricing can be adjusted ([Liu et al., 2019](#)).

Research is necessary on the widespread use of transfer pricing, which is done in many different nations to make it harder for emerging nations to develop. Transfer pricing shows that nations would experience larger tax savings as it occurs more frequently. Consequently, the following first hypothesis is put forth:

H<sub>1</sub>: Transfer pricing has an influence on tax avoidance

### ***Thin capitalization on tax avoidance***

Thin capitalization commonly occurs because the parent company might very well contribute in the form of debt to finance the subsidiary (not capital). Using Australian public firms as the sample, [Taylor & Richardson \(2013\)](#) research discovered that thin capitalization position in the company has a positive and substantial influence on tax avoidance structure. The research of [Afifah & Prastiwi \(2019\)](#), which not only offers empirical data to analyze the determining thin capitalization toward tax avoidance in multinationals but in local enterprises

as well, demonstrates the similar outcome. The findings indicate that both domestic and international corporations use thin capitalization as a tax benefit, although multinational companies use thin capitalization more frequently than domestic ones. According to a study by [Falbo & Firmansyah \(2018\)](#), a rise in tax income in Indonesia is not followed by an increase in the tax ratio, which is another comparable finding. Low tax percentage demonstrates Indonesia's habit of tax avoidance.

Thin capitalization is the second-largest cause of international tax avoidance. The following is the second theory that is brought forth:

H<sub>2</sub>: Thin capitalization has an influence on tax avoidance

***Moderating role of corporate governance on relation between transfer pricing and tax avoidance***

Transfer pricing is undoubtedly the primary way used to reduce taxes. Transfer pricing strategies take advantage of chances to increase private profits by avoiding paying taxes. Businesses utilize transfer pricing techniques to cut their tax bills ([Sikka & Willmott, 2010](#)). Using the transfer price strategy, MNCs may price intermediary products moved between subsidiaries and parent corporations to maximize total profits while avoiding significant amounts of taxes ([Zhao et al., 2012](#)).

Although there is a positive correlation between tax avoidance and transfer pricing, where high transfer pricing leads to high corporate tax avoidance, corporate governance can be an obstacle to tax reduction if the firms implement the corporate governance. Corporate governance enables management to be indulged in through a supervisory process ([Firmansyah et al., 2022](#)). Corporate governance acts as a check and balance inside an organization to guard against straying from the goal of tax avoidance ([Desai & Dharmapala, 2006](#)). Corporate governance enables adequate control over the business operation to prevent the manipulation of corporate earnings and prevent tax avoidance.

The presence of corporate governance as a moderating factor is anticipated to have a detrimental impact on the association between transfer pricing and tax avoidance. Hence, the third hypothesis is consequently put out as follows:

H<sub>3</sub>: Corporate governance weakens the relation of transfer pricing and tax avoidance

***Moderating role of corporate governance on relation between thin capitalization and tax avoidance***

Thin capitalization is a large determinant in tax avoidance ([Taylor & Richardson, 2013](#)). Despite the fact that there is a positive correlation between tax avoidance and thin capitalization, where high tax avoidance is driven by thin capitalization by raising corporate debt, effective corporate governance can be a barrier to tax reduction if the company has it.

Institutions for corporate governance have the ability to limit avoidance to a level where the dangers are not outweighed by the benefits ([Kovermann & Velte, 2019](#)). Corporate governance weakens the influences which can lower state revenues and ultimately hurt the state ([Wahyudi et al., 2021](#)). Good corporate governance may take on the job of controlling and overseeing management practices that minimize earnings in order to pay low taxes in order to meet the company's tax-paying aim ([Widarjo et al., 2021](#)).

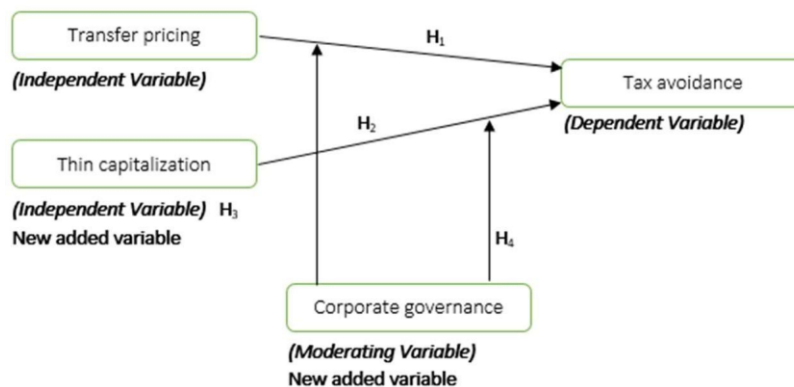
Additionally, corporate governance is expected to weaken the link between tax avoidance and thin capitalization. Corporate governance may either prevent the occurrence of

tax avoidance when used appropriately by corporate. Therefore, the next is how the third theory is set forward by the:

H4: Corporate governance weakens the relation of thin capitalization and tax avoidance

### Research framework

Figure 1. Research Design



### RESEARCH METHOD

In this study, quantitative research is combined with secondary data from IDX and the official websites of the companies involved. Quantitative data is information that takes the shape of numbers and is typically gained through structured questions or from freely accessible information gathered from numerous sources while secondary quantitative research is existing data that do not need to be gathered again by the researcher (Sekaran & Bougie, 2016).

According to the Organization for Economic Cooperation and Development (OECD), large businesses involved in manufacturing and distributor/merchandising companies frequently engage in tax avoidance. However, only manufacturing companies are being examined in this study because the long and complex process of creating a produced good up to sell the goods may point to the manipulation of a number of funds to reduce taxes, whereas the quick process of merchandising could be easily observed, meaning the possibility of manipulating some funds is minimal.

Study by Prastiwi & Ratnasari (2019), Gumpert et al. (2016), and Cai & Liu (2009) who looked at manufacturing firms as research subjects and found that these businesses demand a lot of capital for the management of products. Manufacturing businesses are a type of business that practice sustainable production thus this claim is supported by prior findings.

The population for this study is 579 annual reports from 193 firms and the sample for this study is made up of 77 annual reports from 30 manufacturing enterprises that were gathered from Indonesia Stock Exchange (IDX) and official manufacturing enterprises' websites between 2019 and 2021 for the past three years. In order to get the answers to the study questions, manufacturing firms are being used as a sample. In addition, this form of business is the one that contributes the most to taxes in a nation where it undoubtedly earns a lot of money annually. The following are the requirements for sample removal using purposive sampling.

Table 1. Sample Examining Standard

Examining Standard	Number of Companies Meet the Standard	Number of Annual Reports Meet the Standard from 2019 - 2021
Periods 2019-2021, from Indonesia Stock Exchange (IDX)	193	579
Not classified as main board on Indonesia Stock Exchange (IDX)	(110)	(330)
Delisting yet from the Indonesia Stock Exchange (IDX) during the period time of research observation	0	0
Not having the published and completed annual reports during the period time of research observation	(5)	(15)
Not having transactions with related parties (special relation between parent and subsidiaries companies) or multinational companies	(26)	(78)
Annual reports have the losses in the income statement	(16)	(48)
Annual reports not in Indonesian currency	(5)	(15)
Outlier (from SPSS recommendation)	(1)	(16)
Final Total	30	77

#### ***Tax avoidance measurement***

Tax payers discover ways to lower their taxable income base, which reduces the state's capacity to enforce laws and collect taxes called tax avoidance as the objective through legal usage tax regulations by tax planning which can take many different forms (Mocanu et al., 2021; Wang et al., 2020).

Cash effective tax rate (CETR) is being used to calculate the scope of tax avoidance (Panjalusman et al., 2018). The CETR ratio measures the company's pre-tax earnings in relation to the amount of cash available to pay taxes. As a result, CETR is utilized as an indicator of tax avoidance since it indicates the condition of taxes that have really been paid in cash.

Since the business pays its taxes to the state, tax avoidance is considered to be low if the CETR is high, which is near to the corporation tax rate of 25%. On the other hand, if the CETR is low, tax avoidance is considered to be high. A company's total tax burden, which includes both domestic and international tax rates, is represented by its cash effective tax rate (CETR), which is calculated by comparing tax payments to earnings before taxes (Nurrahmi & Rahayu, 2020). The following formula describes the cash effective tax rate (CETR):

$$\text{Cash effective tax rate (CETR)} = \frac{\text{Tax payment}}{\text{Earning before tax}}$$

#### ***Transfer pricing measurement***

Transfer pricing in a business demonstrates the presence of a special connection between the parent and subsidiary companies. Trade accounts receivable transactions, especially in the trade receivables section to linked parties in the financial statements, can be used to detect transfer pricing (Tiwa et al., 2017). The formula to calculate the amount of transfer pricing is the ratio of the quantity of trade accounts receivables connected to related parties with the sum of all trade receivables of a firm (Tiwa et al., 2017). The following formulation calculated how much transfer pricing is:

$$\text{Transfer pricing} = \frac{\text{Accounts receivable from connected parties}}{\text{Sum of all accounts receivable}}$$

#### **Thin capitalization measurement**

Thin capitalization, sometimes known as "highly leveraged," is a scenario when a corporation has much more debt than capital (OECD, 2012). The ratio of a company's debt to its equity is known as thin capitalization. The method for measuring thin capitalization in this study is maximum allowable debt (MAD) adapted from Falbo & Firmansyah (2018) in accordance with Indonesia's thin capitalization ratio requirements.

First, determine the size of the limit necessary to report a fair transaction that is eligible for an income tax reduction first or that is called safe harbor debt amount (SHDA). The safe harbor debt amount (SHDA) is calculated by subtracting the average non-interest-bearing liabilities from the average total assets, then multiplied with the ratio of the authorized debt to the company's equity which is based on Income Tax Law and Regulation of the Minister of Finance (PMK) Number 169/PMK.010/2015 regulations, or equal to 80% (Falbo & Firmansyah, 2018). The calculation for the safe harbor debt amount (SHDA) is as follows:

$$\text{Safe harbor debt amount (SHDA)} = (\text{Average total assets} - \text{Average non-interest-bearing liabilities}) \times 80\%$$

Second, determine if the amount of interest-bearing debt on the capital structure of the firm exceeds the appropriate to the purpose by thin capitalization provisions, calculate the maximum allowable debt (MAD) ratio by dividing the total debt (including interest-bearing debt) against the safe harbor debt amount (SHDA) (Falbo & Firmansyah, 2018). Maximum allowable debt (MAD) is formulated as follows:

$$\text{Maximum allowable debt (MAD)} = \frac{\text{Average interest-bearing liabilities}}{\text{Safe harbor debt amount (SHDA)}}$$

#### **Corporate governance measurement**

Good corporate governance refers to a structure, method, and process utilized by corporate organs in an effort to generate value to the business that is sustainable over the long term by taking into consideration the interests of other parties and stakeholder-based norms, ethics, culture, and standards (Tandean & Winnie, 2016). Indonesia Corporate Governance Index (ICGI) is a measurement to identify the corporate governance variable (Tanjung, 2020).

The fifteen elements that make up the Indonesia Corporate Governance Index (ICGI) are: (1) code of ethics; (2) anti-corruption; (3) insider trading; (4) largest shareholder; (5) free float; (6) employee share ownerships; (7) corporate social responsibility; (8) whistleblowing; (9) sanctions; (10) big 4 auditors; (11) disclosure of the ultimate beneficiary shareholders; (12) independent director; (13) independent commissioner; (14) size of the board of director; and

(15) size of the board of commissioner. Researcher [Tanjung \(2020\)](#) applied the Indonesia Corporate Governance Index (ICGI) in earlier studies. Additionally, by analyzing the information in the company's annual report, all of the elements which need to determine the corporate governance can meet the criteria.

Every element would be given a value of "1" if the companies meet the criteria, and a value of "0" for elements that companies do not meet the criteria. Thus, corporate governance is determined by dividing the maximum value of the overall score given to each firm by the sum of the scores on the Indonesia Corporate Governance Index (ICGI), which is generated from the criteria to the elements. How to calculate corporate governance can be described by the following formula:

$$\text{Indonesia Corporate Governance Index (ICGI)} = \frac{\sum_{i=1}^n X_{ij}}{\sum_{i=1}^n M_i}$$

Description:

$X_{ij}$ : represents the actual score each firm achieved

$M_i$ : the highest rating given to the business throughout all categories

#### **Data analysis technique**

##### **Multiple linear regression analysis**

In order to examine the independent variables, thin capitalization and transfer pricing, on the dependent variable, tax avoidance, this researcher utilized the procedure of multiple linear regression analysis. As well as to determine how to examine the moderating variable, namely corporate governance, to the relation independent variables, namely transfer pricing as well as thin capitalization, on the dependent variable, namely tax avoidance. The moderating variable operates as a variable in determining how strongly or how weakly the independent and dependent variables are related. Pure moderation is the kind of moderating variable that was employed in this investigation. This is necessary in order to fully analyze corporate governance as a moderating variable in this study. With the following multiple linear regression equation:

$$TA = \alpha + \beta_1.TP + \beta_2.TC + \beta_3.TP*CG + \beta_4.TC*CG + \epsilon$$

Description:

TA : dependent (tax avoidance)

$\alpha$  : constant

$\beta_1$  : dependent coefficient of transfer pricing

TP : transfer pricing

$B_2$  : dependent coefficient of thin capitalization

TC : thin capitalization

CG : corporate governance

$B_3$  : moderated coefficient of transfer pricing and corporate governance TP\*CG

: interaction between transfer pricing and corporate governance

$B_4$  : moderated coefficient of thin capitalization and corporate governance

TC\*CG : interaction between thin capitalization and corporate governance

$\epsilon$  : standard error

##### **Classic assumption test**

The analysis undertaken in this study is done in phases, with the classic assumption test



being used in the first part. Classic assumption test to make sure the regression equation is proper and appropriate for the data obtained. To figure out whether the implemented regression model is accurate, a number of traditional assumption test analyses must be run. The normality test, multicollinearity test, heteroscedasticity test, and autocorrelation test are all components of the classical assumption test.

#### ***Normality test***

According to [Ghozali \(2016\)](#), the normality test determines whether a predetermined regression model's independent and dependent variables have normal or abnormal distributions. Statistical tests would generate lower results if a variable is not normally distributed. The Kolmogorov-Smirnov technique is the type of normality test applied to the data in this study (test goodness of fit normal distribution).

The Kolmogorov-Smirnov approach is applied because the data obtained is not in the form of groups, the data obtained is on an interval or ratio scale, and there are more than 30 data points in the sample. If there are no statistically significant variations between the examined data or if the test value exceeds 0.05, the data is thought to be normally distributed. Additionally, if the analyzed data exhibits significant differences and the test result is below 0.05, the data is considered not to be normally distributed.

#### ***Multicollinearity test***

To discover whether the regression model correctly found a connection between independent variables, the multicollinearity test is used ([Ghozali, 2016](#)). The tolerance value and the Variance Inflation Factor value (VIF) can be used to determine the existence or lack of multicollinearity in the regression model. The tolerance value illustrates the diversity of the selected independent variables that cannot be explained by additional independent variables. For the tolerance number, the recognized standard value is 0.1, while the VIF value is 10. According to [Ghozali \(2016\)](#), the multicollinearity test has the following conditions:

- If the tolerance value is below 0.1 or the value of the VIF exceeds than 10, there is a multicollinearity problem.
- If the tolerance value exceeds 0.1 or the value of the VIF is below 10, there is no multicollinearity problem.

#### ***Heteroscedasticity test***

The purpose of a heteroscedasticity test in a regression model is to discover whether there is significant variation in the residual from one measurement to another.

Heteroscedasticity is the term used when the variances differ. In the opinion of [Ghozali \(2016\)](#), good research is research in which there is no heteroscedasticity. To determine if a multiple linear regression model contains heteroscedasticity, the Glejser Test is performed in the research. According to [Ghozali \(2018\)](#), the significance value is used as the basis for decision-making under the following circumstances:

- If the significance number exceeds 0.05, there is no heteroscedasticity.
- Heteroscedasticity exists if the significance level is below 0.05.

#### ***Autocorrelation test***

According to [Ghozali \(2016\)](#), when subsequent observations during time are connected

to one another, autocorrelation might occur. The good study is that which does not display autocorrelation. Durbin-Watson can be used to determine if autocorrelation exists or not. The Durbin-Watson test requirements are as follows:

- When  $DW < DL$  or  $D > 4-DL$ , autocorrelation is present.
- When  $DU < DW < 4-DU$ , no autocorrelation is present.
- When  $DL < DW < DU$  or  $4-DU < D < 4-DL$ , no decision can be made.

#### ***F test***

F test, often referred to as the simultaneous technique, model test, or ANOVA test, is a research test used to determine how the contribution of independent variables interacts with the dependent variable. The standard for significance is set at 0.05 or 5%. The independent variable simultaneously affects the dependent variable, or conversely, if the significant value of F is less than 0.05 present (Ghozali, 2016). According to Ghozali (2016), the F test has the following provisions:

- If the significant value of F is below 0.05,  $H_0$  is rejected and  $H_a$  is accepted. This implies that the dependent variable is significantly influenced by all independent variables.
- If the significant value is F exceeds 0.05,  $H_0$  is accepted and  $H_a$  is rejected, which indicates that none of the independent variables have a substantial impact on the dependent variable.

#### ***T test***

T test also known as partial test is an analytical test used to examine research hypotheses regarding the partial effects of each independent variable on the dependent variable. By examining the significance value in the coefficients table, decisions about the results are made. A 95% confidence level or 5% significance level (0.05) was used as the baseline for assessing the regression findings. The T statistical test's requirements are as follows (Ghozali, 2016):

- If the significance value of the T test is greater than 0.05,  $H_0$  is accepted and  $H_a$  is rejected. This indicates that the independent variables have no impact on the dependent variable.
- If the significance value of the T test is less than 0.05,  $H_0$  is rejected while  $H_a$  is accepted. This indicates that the independent variables have an impact on the dependent variable.

#### ***R-square test***

According to Ghozali (2016), the R-square test is a measurement of the coefficient of determination that reveals how much the independent variable model is able to influence the dependent variable. In a regression model, the coefficient of determination demonstrates how much the independent variable influences the dependent variable.

The coefficient of determination has a value between 0 and 1. A value of the coefficient of determination close to 1 indicates that the independent variable provides almost all the information required to predict the dependent variable. Otherwise, the value of the coefficient of determination is decreasing and getting closer to 0, it means that the independent variables have a very limited ability to explain the dependent variable (Ghozali, 2016).

## **RESULTS AND DISCUSSION**

**Classic assumption test**

This study carried out four classic assumption tests, including the normality test, multicollinearity test, heteroscedasticity test, and autocorrelation test, to determine if the data obtained were normal or not.

**Normality test**

The normality test establishes if the specified regression model's independent and dependent variables have a good or bad distribution. Kolmogorov-Smirnov is the type of test utilized for this normality test. The test's results are detailed below.

Table 2. Kolmogorov-Smirnov Test's Results Before Eliminating Outlier and Data Transformation

<b>One-Sample Kolmogorov-Smirnov Test</b>		
Unstandardized Residual		
N		93
Normal Parameters	Mean	.000000
	Std. Deviation	.53075377
Most Extreme Differences	Absolute	.309
	Positive	.309
	Negative	-.249
Test Statistic		.309
Asymp. Sig. (2-tailed)		.000

According to the findings of the foregoing Kolmogorov-Smirnov analysis, the collected data is not normally distributed with an Asymp. Sig. (2-tailed) value of 0.000, less than 0.05. To validate the data for the following step, however, another method is required. The solution is to employ outliers and also perform data transformation. The outlier is the need to remove extremely significant data inaccuracies or errors. In order to evaluate the data in SPSS, it was recommended by SPSS that 16 annual reports from 11 firms be eliminated. Data transformation is a technique used to turn random numbers that fail the test into regular data. The natural logarithm is the data change employed in this research on two independent variables, transfer pricing and thin capitalization.

Table 3. Kolmogorov-Smirnov Test's Results After Eliminating Outlier and Data Transformation

<b>One-Sample Kolmogorov-Smirnov Test</b>		
Unstandardized Residual		
N		773
Normal Parameters	Mean	.000000
	Std. Deviation	.09559137
Most Extreme Differences	Absolute	.082
	Positive	.068
	Negative	-.082
Test Statistic		.082
Asymp. Sig. (2-tailed)		.200

The gathered data is now normally distributed with an Asymp. Sig. (2-tailed) value of 0.200, greater than 0.05, according to the Kolmogorov-Smirnov analysis discussed above.

#### **Multicollinearity test**

To ascertain how closely related the independent variables in research are to one another, the multicollinearity test is performed on the independent variables. The Variance Inflation Factor (VIF) value or the tolerance value is used to determine the foundation for the conclusion. Multicollinearity does not appear in good research.

Table 4. Multicollinearity Test's Results

Model	Coefficients	
	Collinearity Statistics	
	Tolerance	VIF
(Constant)		
Transfer Pricing	.275	3.631
Thin Capitalization	.129	7.731
Transfer Pricing * Corporate Governance	.258	3.881
Thin Capitalization * Corporate Governance	.131	7.622

According to the findings of the multicollinearity test analysis after transforming, the tolerance value is greater than 0.1 and the VIF value of each independent variable is less than 10, indicating that there is no multicollinearity in the data produced.

#### **Heteroscedasticity test**

The heteroscedasticity test determines if the variables in the applied regression model have different variances. The White Test is the kind of heteroscedasticity test employed in this study. Heteroscedasticity is not present in good research. The significance value emphasizes how to interpret the Glejser Test results.

Table 5. Glejser Test's Results

Model	Coefficients	
	t	Sig.
(Constant)	2.107	.039
Transfer Pricing	-1.042	.301
Thin Capitalization	1.959	.054
Transfer Pricing * Corporate Governance	-.478	.634
Thin Capitalization * Corporate Governance	-1.170	.246

According to the findings of the above examination of heteroscedasticity, the significance value of each variable is greater than the standard significance value 0.05. According to the findings, the data has no heteroscedasticity.

#### **Autocorrelation test**

The autocorrelation test is used to determine whether residual errors over the data collecting period are related. The data used for this autocorrelation test has a time series (continuous) character. Autocorrelation does not appear in good research. Durbin-Watson is the sort of autocorrelation test employed in this study.

Table 6. Durbin-Watson Test's Results

Model Summary					
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
	.219	.048	-.005	.098211	1.915

According to the findings of the study of the Durbin-Watson used to test for autocorrelation, there is no autocorrelation. The results display DW (1.915) while 4-DU (2.260), DU (1.740), and DL (1.522). When  $DU < DW < 4-DU$ , the conclusion follows that  $1.740 < 1.915 < 2.260$ , or no autocorrelation occurred.

#### F test

The F test is a simultaneous test that determines whether or not all independent variables have a combined impact on the dependent variable. The measurement value for the F test is the significance value. The F test results in this study are described in the manner that follows.

Table 7. F Test's Results

ANOVA					
Model	Sum of Squares	df.	Mean Square	F	Sig.
Regression	.035	4	.009	.907	.465
Residual	.694	72	.010		
Total	.729	76			

The results of the F test analysis above indicate a significance value of 0.465, which is higher than the accepted significance level of 0.05, indicating that no independent variable in the multiple regression model has an equal impact on the dependent variable.

#### T test

The T test, also known as the partial test, evaluates how each independent variable in the research interacts with the dependent variable. The significance value is the measurement value that is employed. The T test's findings, which are stated in this research as follows, are as follows.

Table 8. T Test's Results Coefficient

Coefficients					
Model	Unstandardized Coefficients		Standardized Coefficients		
	B	Std. Error	Beta	t	Sig.
(Constant)	.264	.121		2.183	.032
Transfer Pricing	.002	.025	.021	.097	.923
Thin Capitalization	.043	.106	.128	.402	.689
Transfer Pricing * Corporate Governance	-.106	.109	-.221	-.973	.334
Thin Capitalization * Corporate Governance	-.006	.203	-.009	-.028	.978

From the table of regression analysis, the model can be determined as:

Tax avoidance =  $0.264 + 0.002 \text{ Transfer Pricing} + 0.043 \text{ Thin Capitalization} - 0.106 \text{ Transfer Pricing} * \text{Corporate Governance} - 0.006 \text{ Thin Capitalization} * \text{Corporate Governance}$

There are several results for each independent variable on the dependent variable, tax

avoidance, based on the results of the T test described above, which are stated as follows:

a. Transfer Pricing

Based on the above-mentioned T test results, transfer pricing has a significance value of 0.923, which is greater than the threshold of 0.05. Transfer pricing therefore has no influence on tax avoidance.

b. Thin Capitalization

Based on the identified T test findings, thin capitalization has a significance value of 0.689, which is higher than the threshold of 0.05. Thin capitalization hence has no influence on tax avoidance.

c. Interaction between Transfer Pricing and Corporate

The T test's findings show that the interaction between transfer pricing and corporate governance has a significance value of 0.334, which is greater than the typical significance value of 0.05. Thus, corporate governance cannot moderate the relationship transfer pricing towards tax avoidance.

d. Interaction between Thin Capitalization and Corporate Governance

The T test findings indicate that interaction between thin capitalization and corporate governance has a significance value of 0.978, above the typical significance value of 0.05. Thus, corporate governance cannot moderate the relationship thin capitalization towards tax avoidance.

***R-square test***

The R-square test evaluates the relationship between the independent and dependent variables and measures the degree of effect that the independent and dependent variables have on one another. The determinant coefficients caused the R-square test. The following provides an explanation of the R- square test results.

Table 9. R-square Test's Results

Model Summary					
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
	.219	.048	-.005	.098211	1.915

According to the above R-square test results, the results reveal that the adjusted R-square has a coefficient of determinant of 0.048 or closer to 0. All independent variables, transfer pricing and thin capitalization, illustrate for 4.8% proportion to influence tax avoidance. This value describes that the determinant coefficient is approaching zero, which means that all independent variables have almost no information to predict the dependent variable and hardly any ability to influence the dependent variable. Meanwhile, other factors, outside the research model, are impacted by 95.2%.

## CONCLUSION

According to the results of the SPSS test analysis, transfer pricing and thin capitalization, which are indicators of tax avoidance, are not tax deduction strategies used by multinational corporations. Companies may do tax avoidance with other methods which are deserving of further study. Additionally, the business still has numerous regulatory gaps in the field of the corporate governance section under study, so corporate governance as moderation cannot be said to be effective at preventing tax avoidance.

This research is to examine the factors that contribute to tax avoidance indicators, such as transfer pricing and thin capitalization, as well as corporate governance's potential to moderate the connection between transfer pricing and tax avoidance and the connection between thin capitalization and tax avoidance. A selection of manufacturing firms from the basic materials, consumer cyclical, consumer non-cyclical, healthcare, and industrial sectors that were listed on the IDX between 2019 and 2021 is used in this study. The examination of the manufacturing sample resulted in the following conclusions, which are then drawn.

Tax avoidance is unaffected by transfer pricing; the significance value of transfer pricing indicates that 92.3% or higher than 5%. hypothesis 1 is rejected. Due to the fact that the manufacturing companies under study, 7 parent companies and 23 subsidiary companies, are subsidiaries rather than holding companies [Appendix 2](#), those who engage in tax avoidance through transfer pricing are typically parent companies that engage in connected business activities with subsidiaries. In addition, regardless of the account receivables under research, the subsidiary company should be carrying a large amount of money if the parent company engages in tax avoidance through affiliated transactions.

As opposed to the study's findings, which showed that the average proportion of accounts receivable from related parties at manufacturing firms was only 29% from all accounts receivable. The quantity of money that is now accessible in accounts receivable from connected parties determines tax avoidance ([Tiwa et al., 2017](#)). Additionally, because of the lack of transfer pricing documents in the financial statements, the information gathered cannot adequately describe how transfer pricing is used to escape paying taxes. Transfer pricing documents are private in nature, which means that only the parent business and the finance government are informed of them.

Tax avoidance is not impacted by thin capitalization; the significance value of thin capitalization indicates that 68.9% or higher than 5%. hypothesis 2 is rejected. This occurs because most research objects have a small ratio of Maximum Allowable Debt (MAD), which is 40% which indicates small thin capitalization action in manufacturing companies. According to [Income Tax Law and Regulation of the Minister of Finance \(PMK\) Number 169/PMK.010/2015](#) regulations which only permits maximum debt- to-equity ratio of (4:1) or allow no more than 80% of the total amount of equity + debt; if this amount is exceeded, thin capitalization is discovered as a tax deduction through tax interest expense. Whereas the MAD ratio is a metric used to analyze if thin capitalization has occurred to help businesses avoid paying taxes ([Falbo & Firmansyah, 2018](#)). Thin capitalization in this MAD computation refers to the amount of interest-bearing debt a corporation has as a tax-saving expenditure. Therefore, tax avoidance is not impacted by thin capitalization.

The connection between transfer pricing and tax avoidance is unaffected by corporate governance as a moderator, as evidenced by the significance level value, which is 33.4% or higher than 5%. hypothesis 3 is rejected. In this study, corporate governance as a moderating variable was unable to reduce the impact of transfer pricing on tax avoidance. It can be argued that corporate governance adopted by the company has not been carried out optimally ([Widarjo et al., 2021](#)). Resulting corporate governance of the company only serves as a formality to show that the company follows with policies and regulations when conducting business. Furthermore, there is no specific transfer pricing policy in the corporate governance practices of the company. The company only has general regulations to monitor ongoing business operations.

The connection between thin capitalization and tax avoidance is unaffected by corporate governance as a moderator, as evidenced by the significance level value, which is 97.8% or higher than 5%. hypothesis 4 is rejected. The findings of this study can be explained by the possibility that companies have not implemented optimal corporate governance. Corporate governance of the company only provides as a formality to demonstrate that the company complies with policies and laws when conducting business. Furthermore, the corporate governance held by the business lacks a specific policy governing thin capitalization. To regulate and manage continuing business activities, the firm only has general regulations.

### **Limitations**

The limitations of this study's findings can be used to fill in research gaps for future studies in the following ways.

1. Respectively, 2019, 2020, and 2021 are the only three financial reporting years used in this research.
2. Only Indonesian manufacturing firms of certain kinds are used in this research.
3. Only four variables, including transfer pricing and thin capitalization towards tax avoidance, and company governance as a moderator, are examined in this study.

### **Suggestions**

This research offers a number of recommendations that can be used as guidance when making decisions.

1. Future researchers can conduct additional research because the transfer pricing measurements used in this study are incompatible with transfer pricing, and they can also propose alternative measurements to identify tax avoidance, such as the Effective Tax Rate



- (ETR), to compare with the Cash Effective Tax Rate (CETR).
- To conduct further research, it is recommended to use additional factors that may be indicators of tax avoidance, to use various research objects because tax avoidance is not just a practice of manufacturing companies, and to use a longer research time.
  - Companies should enhance their corporate governance. Because of the findings of the study, the corporate governance of the business is weak. There are no regulations or sanctions for breaking the company's given policies, just like in the "sanctions" part.

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## APPENDIX

### Appendix 1

Indonesia Corporate Governance Index (ICGI)	
Research Section	Details
Code of ethics	Firm has vision, mission, value, policy, and regulation
Anti-corruption regulation	Firm has anti-corruption and anti-bribery policy
Insider trading regulation	Firm has policy against insider trading
Largest shareholder	Firms owns less than 50% voting right
Free float	Minority shareholders (public investors) own more than 7.5% voting right
Employee share ownership	Firm issues Employee Stock Option Program (ESOP)
Corporate social responsibility	Firm discloses Corporate Social Responsibility (CSR) in annual report
Whistleblowing	Firm has internal whistleblowing mechanism
Sanctions	Firm discloses any information regarding violation any stock market rules and regulations
Big4 auditors	Firm audited by Big4 company
Disclosure of the ultimate beneficiary shareholders	Firm discloses final beneficiary share owner
Independent director	Firm has more than one independent director
Independent commissioner	Independent commissioner portion is more than 30% from total commissioner board
Size of the board of director	Firm has five until nine directors in director board
Size of the board of commissioner	Firm has four until eight commissioners in commissioner board

### Appendix 2

Corporate Sector	Corporate Code	Corporate Name	Kind of Company
Basic Material	EKAD	Ekadharm International Tbk.	Parent
	INCI	Intanwijaya International Tbk.	Parent
	INTP	Indocement Tunggal Prakarsa Tbk.	Subsidiary
	ISSP	Steel Pipe Industry of Indonesia Tbk.	Subsidiary
	MDKI	Emdeki Utama Tbk.	Subsidiary
	SMBR	Semen Baturaja Tbk.	Subsidiary
	SMCB	Solusi Bangun Indonesia Tbk.	Subsidiary
	SMGR	Semen Indonesia Tbk.	Parent
Consumer Cyclical	GJTL	Gajah Tunggal Tbk.	Subsidiary
	SMSM	Selamat Sempurna Tbk.	Subsidiary
	WOOD	Integra Indocabinet Tbk.	Subsidiary
Industrial	ARNA	Arwana Citramulia Tbk.	Parent
	ASII	Astra International Tbk.	Parent
Consumer Non-Cyclical	CEKA	Wilmar Cahaya Indonesia Tbk.	Subsidiary
	CLEO	Sariguna Primatirta Tbk.	Parent

	CPIN	Charoen Pokphand Indonesia Tbk.	Subsidiary
	GOOD	Garudafood Putra Putri Jaya Tbk.	Subsidiary
	HMSP	H.M. Sampoerna Tbk.	Subsidiary
	ICBP	Indofood CBP Sukses Makmur Tbk.	Subsidiary
	INDF	Indofood Sukses Makmur Tbk.	Subsidiary
	JPFA	Japfa Comfeed Indonesia Tbk.	Subsidiary
	MYOR	Mayora Indah Tbk.	Subsidiary
	ROTI	Nippon Indosari Corpindo Tbk.	Subsidiary
	UCID	Uni-Charm Indonesia Tbk.	Subsidiary
	UNVR	Unilever Indonesia Tbk.	Subsidiary
	DVLA	Darya-Varia Laboratoria Tbk.	Subsidiary
	KLBF	Kalbe Farma Tbk.	Parent
Healthcare	PEHA	Phapros Tbk.	Subsidiary
	SIDO	Industri Jamu dan Farmasi Sido	Subsidiary
	TSPC	Tempo Scan Pacific Tbk.	Subsidiary